Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket 96-45
Federal-State Joint Board on	)	
Universal Service	)	

REPLY COMMENTS OF SUREWEST COMMUNICATIONS
ON RURAL TELEPHONE COMPANY *PUBLIC NOTICE*

SureWest Communications, by its attorneys, hereby files these Reply Comments regarding the Comments filed in response to the *Public Notice,* FCC 04J-2, released August 16, 2004, on high-cost universal support mechanisms for rural carriers.

I. Introduction

In its initial Comments in response to the *Public Notice*, SureWest noted that since the passage of the Telecommunications Act of 1996, the Commission has distinguished between two different sets of LECs for the purposes of provision of federal high-cost support funds. While the distinction between the two categories created by the Commission was based only on number of access lines served, rather than on the territory served, the two categories of LECs were nevertheless denoted by the Commission as “rural” and “non-rural” companies. In hindsight, the use of the terms “rural” and “non-rural” in the context of universal service reform was unfortunate. Such terms create incorrect implication that the cost structure of a company is based solely on the location of the company's service area, rather than on factors such as economies of scale and scope, and subscriber density. Indeed, "non-rural" companies serve the majority of the rural subscribers in the country, while some "rural" study areas have lines in urban areas. Many companies serve dense population pockets in rural areas, and in those pockets, the cost of service can be less than that of certain "non-rural" areas.[1] SureWest noted that in this proceeding, the Joint Board has an important opportunity to more accurately target study areas where high-cost support is appropriate, regardless of location.

Accordingly, SureWest suggested that the definition of "rural" for purposes of high-cost support should be modified. While SureWest supported the proposal (*Notice* at para. 14) to differentiate between small, mid-sized, and large companies for the purposes of high-cost support, it suggested that the break points between these categories should be modified to better reflect the economies of scale that drive a company's cost structure.[2] SureWest suggested that the Joint Board should recommend that the following categories of study areas be eligible for varying amounts of high-cost support:

-Study areas with <u>less than 50,000 lines</u>;

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1 *See e.g.,* Rural Task Force White Paper 2, "*The Rural Difference"* (January 2000) at page 21, showing that the service areas of <u>rural</u> carriers in Connecticut and New Jersey average 280 and 247 persons per square mile, while the national average for <u>non-rural</u> carriers is 105 persons per square mile.

2 In creating a different high-cost support mechanism for "rural" carriers, the Commission recognized that a major distinction between "rural" and "non-rural" carriers is economies of scale and scope. *Universal Service First Report and Order*, 12 FCC Rcd at 8936.

-Study areas with less than 100,000 lines; and

-Study areas with less than 200,000 lines.

SureWest asserted that the above categories reflect a more nuanced and accurate picture of the distinctions in economies of scale and scope of different sized operations. SureWest recognized that while the *Notice* did not propose to include study areas with more than 100,000 access lines in the "rural" support mechanism, the fact is that operations in such study areas can in fact be high-cost, especially if that study area is the only one to which a carrier provides service. This is because the economies of scale of such an operation are far less than those of larger carriers. Indeed, the Commission's Part 36 rules recognize that rural carriers with more than 100,000 but less than 200,000 access lines can need support. *See* 47 C.F.R. § 36.631 (carriers with less than 200,000 access lines receive varying levels of support for loop costs greater than 115% of the national average cost). SureWest's proposal is thus consistent with the Commission's Part 36 rules.

II. The Record Is Consistent With the SureWest Proposal.

A review of the comments filed in response to the *Public Notice* shows some diversity of opinion regarding the proper definition of a rural telephone company for these purposes. SBC Communications Inc. notes, in a manner similar to SureWest, that the "arbitrary distinction between purportedly 'rural' and 'non-rural' carriers [is] based on the size of the carrier, and ignore[s] the fact that so-called 'non-rural' carriers in fact serve far more customers in rural and other high-cost areas than 'rural' carriers." Comments at page 2. SBC goes on to advocate that the Joint Board and Commission "abandon the improper distinction between 'rural' and 'non-rural' carriers and develop a mechanism that ensures that all carriers serving rural and high-cost areas receive federal (and state) universal support on an equitable and non-discriminatory basis." *Id*. at pages 3-4.

A number of the comments advocate that no change be made to the definition of rural telephone company for high-cost support purposes. *See, e.g.,* Comments of OPASTCO at page 3, Comments of NTCA at page 4, and Comments of John Staurulakis, Inc. ("JSI") at page 10. These comments are largely driven by an understandable fear that any change to the definition will be one that reduces the category of carriers that are eligible for federal high-cost support. These commenters thus take an "if it ain't broken, don't fix it" approach. *See* Comments of JSI at page 10. Yet, the problem is that the system is broken. As noted by SureWest in its initial Comments, a result of the Commission's decision to use 100,000 access lines as a primary distinction between "rural" and "non-rural" carriers is that the allocation of federal high-cost support is substantially flawed. That is, some study areas served by holding companies with millions of access lines each are classified as "rural," even though those companies have significant economies of scope and scale due to their size, while other study areas are classified as "non-rural," even though the costs of serving such areas can be higher, due to the fact that they are served by stand-alone companies that are much smaller, and thus do not have the same economies of scale. Ultimately, it is subscribers who pay the price, or worse, cannot afford to pay the price, of this flawed allocation of funds. Thus, while SureWest agrees with the underlying concerns of NTCA and OPASTCO, it asserts that the changing the definition of rural telephone company in the manner proposed by SureWest would not exacerbate those concerns.

The National Association of State Consumer Advocates ("NASUCA") urges the Board to make the major definitional distinction at 50,000 access lines: carrier with less than 50,000 lines in a study area would continue to receive support based on embedded costs, while those with more than 50,000 lines would be transitioned to a forward-looking support mechanism like that currently used for "non-rural" carriers. In the process, NASUCA briefly mentions the situation of ST (under its former name Roseville Telephone Company). Commenting on the portion of the *Notice* that contrasts the situations of large holding companies with multiple study areas of less than 100,000 lines with ST's situation of having only one study area with just over 100,000 lines, NASUCA states that "the solution to this contradiction is not to qualify large companies like Roseville Telephone ... Instead, the task is to exclude companies like Sprint Florida from the definition, because they do not display the characteristics that require federal support." Comments at pages 12-13 (emphasis removed from original). In response, SureWest points out that NASUCA's primary concern appears not to be SureWest/Roseville, but rather the large holding companies (such as Sprint) that have numerous "rural" study areas. Indeed, in footnote 52 of its Comments, NASUCA suggests that SureWest/Roseville is more similar to rural carriers than to the

RBOCs with whom SureWest has been placed in the "non-rural" category.[3] In any case, SureWest's Comments recognized that large holding companies with numerous study areas of less than 100,000 lines present a different issue than that of mid-sized companies with only one study area with slightly more than 100,000 lines.

Verizon raises concerns that are similar to those of NASUCA. While it suggests that the growth in the federal high-cost fund is driven in part by support for companies with more than 100,000 access lines, it is clear that the focus of Verizon's concern is with large holding companies that have multiple study areas in a state, yet retain rural telephone company status because each study area is less than 100,000 lines. *See, e.g.,* Comments of Verizon at pages 1,2, 4, 8 and 10.

While parties such as Verizon do not support the inclusion of include study areas with more than 100,000 access lines in the "rural" support mechanism, the fact is that operations in such study areas can in fact be high-cost. Factors that can make such study areas high-cost include geographic surface conditions, such as volcanic rock or permafrost, that require expensive specialized plant construction practices.[4]

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[3] NASUCA's suggested use of 50,000 lines as the primary definition of rural telephone company appears to be a compromise between the current definition of 100,000 lines, and NASUCA's assertion that costs associated with operational variables of companies show the greatest difference above and below the 20,000 line mark. NASUCA Comments at page 16. NASUCA relies on figures in *The Rural Difference* for its assertion, yet it provides no statistical analysis supporting that assertion. Indeed, on page 16 of its Comments, it points to average gross central office equipment investment per loop, yet Figure 18 of *The Rural Difference* shows an average COE investment of $537 for carriers with 5,000-10,000 lines, $499 for carriers for 10,000-20,000 lines, $467 for carriers with 20,000-50,000 lines, $463 for 50,000-100,000 lines, and $437 for carriers with greater than 100,000 lines. This does not show a significant break at the 20,000 line mark.

[4] *See, e.g., The Rural Difference* at pages 10 and 27.

Furthermore, study areas with 100,000 -200,000 lines can be high-cost because the economies of scale of such an operation are far less than those of larger carriers in the "non-rural" category. This is especially true if the study area is the only one to which a carrier provides service. For example, Figure 15 of *The Rural Difference* shows that rural study areas of more than 100,000 lines average 2,905 lines per switch, while non-rural study areas average 7,188 lines per switch. This 247 percent difference in density results in very real differences in costs of providing service.

Thus, SureWest asserts that there should be some level of federal high-cost support for study areas with more than 100,000 but less than 200,000 access lines. As previously noted, such an approach is consistent with the Commission's Part 36 rules.[5] SureWest recognizes the concern that adding the category of study areas with less than 200,000 lines to the definition of rural telephone company may add to the size of the high-cost fund, but it is very unlikely that any resulting impact will be significant. First, the limitation that such study areas be the <u>only</u> study area of the serving carrier will substantially limit the number of such eligible study areas. Furthermore, other proposals in the *Notice*, such as taking into account holding company status, if adopted, will reduce the current size of the fund substantially more than any increase resulting from the proposal herein.

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[5] *See* 47 C.F.R. § 36.631 (carriers with less than 200,000 access lines receive varying levels of support for loop costs greater than 115% of the national average cost).

III. Conclusion

The definition of "rural telephone company" for purposes of high-cost support must be modified, in order to remedy the flawed allocation of federal high cost funds, and the improper denial of such funds to study areas that should receive it. SureWest urges the Joint Board to recognize the needs of study areas served by mid-sized carriers, and adopt the three-tiered categories of study areas eligible for varying amounts of high-cost support set forth in its initial Comments.

Respectfully submitted,

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December 14, 2004